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NOTES AND MEMORANDA

DEPOSIT GUARANTY IN MISSISSIPPI

It may seem a far cry from the boll weevil to deposit guaranty. But remembering the relation of the chinch bugs in the Missouri Valley to the free silver movement of the nineties, one realizes that an insect may be a cause of financial legislation proposed or enacted. For several years, in Mississippi south of the 33d parallel, the cotton crop had been almost destroyed by the boll weevil. In a typical county, Pike, the normal crop of 25,000 bales fell to 3,600 bales in 1913. In other sections of the state the crop was injured by the army worm, and in the Delta section by overflows from the Mississippi River. At the same time the state banks were running without supervision. The statutes were not entirely lacking in banking provisions, and some of the provisions were in themselves very good, but there was no bank examination and no verification of reports. "In a word," says a Mississippi legislator, "Mississippi state banks were simply chartered by the state and turned loose to do business just as they would."

It was inevitable that many banks should fail. There is no official list of the failures, but a list privately compiled showed 22 bank failures in 1912 and 1913 and 7 more early in 1914. The deposits were not ascertained in all cases; so far as known, they amounted to $4,600,000. The number of banks reporting to the state auditor fell from 342 in June, 1911, to 306 in June, 1914. National banks increased in number from 31 to 37. There was an attempt in the legislature of 1912 to enact a banking law. It failed largely because the Senate and House could not agree on the method of selecting the bank examiners. A majority of the Senate

wished the examiners to be appointed, while the House wanted them elected by popular vote.

By 1914, it was evident that something must be done. There was a bank failure just as the legislature met, and failures occurred all through the session. Not satisfied now with a bill for safeguards and supervision, many legislators insisted from the start on the guaranty of bank deposits. The Mississippi Bankers Association, with much the same arguments that had been used before the legislatures of other states,[1] opposed the guaranty sections to the end. It is possible that if the members of the Association had foreseen the ultimate adoption of deposit guaranty, they could have made participation optional with the banks, and could have provided for appointive, instead of elective, bank examiners. After a long struggle a bill was finally passed in March and was signed by the governor March 9th.

More striking even than the deposit guaranty plan is that of electing the three bank examiners. It is not quite without precedent, for in some states bank supervision is committed to an elective officer, — the state treasurer, state auditor, or secretary of state. The need of technical qualifications in a bank examiner is self-evident, and therefore only those citizens may become candidates who have passed an examination to determine their fitness. Examinations are given by a Board of Bank Commissioners, composed of a successful banker and business man appointed by the Governor, an experienced lawyer appointed by the Attorney General, and an experienced accountant appointed by the State Auditor. Examinations will be held in March, preceding the general election in November; special examinations will be given at other times on payment of a $50.00 fee. Applicants will be examined in accounting, theory and practice of banking and the banking laws of Mississippi, and the federal banking law. Every applicant who makes a grade of 75 per cent, is of good moral character, a practical accountant, and has never been the manager of a banking or other business enterprise which

[1] Quarterly Journal of Economics, vol. xxiv, pp. 85, 327, reprinted in Sen. Doc. no. 649, 61st Cong., 3d Session, Appendix B.

has failed or liquidated below par during his management, will receive a license to become a candidate for state bank examiner. The license is good for four years. One examiner is to be elected from each of the three supreme court districts.

As no general election would occur soon after the passage of the new law, it was provided that the applicant from each district who made the highest grade in the first examination should be a bank examiner until January, 1916. It is reported that the examination was a good one, and as well calculated as an examination could be to test the knowledge of would-be bank examiners. In one of the questions it was asked what a cashier should do if a prospective borrower, on being asked for security, offered to obtain the endorsement of a solvent oil mill company. Almost all of the applicants are said to have favored discounting the note so endorsed. They were apparently unaware that an accommodation endorsement is beyond the powers of a corporation.

There is no head to the Mississippi bank department. All the bank examiners are of equal authority. The three examiners constitute a board, it is true, and there is a chairman, but his special authority is of the slightest. On the request of the board of directors of any bank for a special examination, he must designate one of the examiners to make such examination. In addition to the regular quarterly meetings of the board of bank examiners the chairman may call other meetings if he deems additional meetings necessary. In these two matters only has he authority beyond his colleagues. Apparently the office of the department will usually be in charge of the board's secretary. The examiners are examiners in fact. They go into the field and themselves inspect the banks. For this they receive $3,000 per annum each and their expenses for railroad fare, livery hire and hotel bills. Incidentals are not allowed. The examiners even have to pay part of the compensation of any assistants who may be necessary. Subject to a limit of $150 per month each, assistant examiners will receive $10.00 per day, of which one-fourth must be paid by the three elected bank examiners personally. The experiment of running a state bank depart-

ment without a head and with examiners chosen by popular vote, who are personally out of pocket if they find it necessary to employ assistants, will be followed with interest.

The general administrative features of the law are in the main satisfactory. Banks are to be examined twice a year. The examiners have power to subpoena witnesses, probably a new provision in banking laws. The authority to close banks for violation of law or impairment of condition is adequate. Private banks of deposit are required to incorporate. It will be remembered that a like provision in the Nebraska bank law was the subject of litigation ending only in the Supreme Court of the United States, where the provision was upheld.[1] New banks may be organized only by persons of "good moral and safe business character." The state has wisely not followed the example of Kansas, which gives to its board power to deny a charter merely because the board may doubt the need of a bank at the contemplated location. The right of the citizen to determine for himself the chances of his business venture, so he be a safe man, is preserved. A scale of minimum capital is adopted, ranging from $10,000 to $50,000 according to location. This does not apply to existing banks. The limit on single lines of credit is high, 25 per cent of capital and surplus, as in Missouri, South Dakota and Texas. In Mississippi and South Dakota a bank may go further and discount without any limit business paper owned by its customers. The limit on deposits makes it unlawful for any guaranteed bank to receive deposits continuously for six months in excess of ten times its paid up capital and surplus. This is the Kansas law. Mississippi, however, excepts savings banks from its operation.

The law has some anti-trust sections of highly modern purport. "No person shall be permitted to be a director in more than one bank serving the same incorporated town or city." This does not apply, however, "to savings banks and trust companies operated in connection with commercial banks doing business in the same building." Clearing houses must incorporate, and are forbidden to make rules

[1] Quarterly Journal of Economics, vol. xxviii, p. 70.

concerning exchange rates, discount rates, interest on deposits, collection fees, or restricting competition in any other way.

We come now to the guaranty provisions. These closely follow the Kansas law, with the important exception that guaranty, optional with the banks in Kansas, is obligatory for those of Mississippi. A compromise was reached in Mississippi by which banks need not come within the guaranty provisions of the law until May 15, 1915. This interval has proved invaluable, as examiners have already closed some twenty banks, a number sufficient to have been a menace to the success of the whole scheme if their deposits had been guaranteed at once and automatically.

As in Kansas, the banks must be examined before their deposits are guaranteed. Each bank must deposit bonds or cash with the state to the amount of $500 for every $100,000 of deposits eligible to guaranty, less the capital and surplus of the bank. The annual assessment for the guaranty fund is one-twentieth of one per cent of deposits, with the same wise deduction for capital and surplus. Four additional assessments of like amount may be made in any year, if required. Assessments are suspended when the fund reaches $500,000. Following the Kansas rule, the guaranty fund, like other state funds, is kept in state depository banks, whereas in Nebraska all the assessments, and in Texas 75 per cent of them, are left on deposit with the assessed banks until cash is needed. All deposits not otherwise secured are guaranteed, except those bearing more than 4 per cent interest. These provisions all follow the Kansas law exactly, except that Kansas no longer withholds guaranty because of the interest rate. Both states provide that a maximum rate of interest on deposits may be fixed for each county, and that any bank officer who pays a higher rate "shall be deemed to be reckless, and may be removed from office."

Mississippi has followed the Kansas plan of deferring final payment of depositors of failed banks until assets, including the double liability of stockholders, shall have been realized on so far as is possible. In the meantime 6 per cent certificates are to be issued to the depositors, and dividends are to

be paid as collections are made from the assets. The advantage of this plan is that it prevents the exhaustion of the guaranty fund by one or two failures. Oklahoma, Nebraska and Texas provide that depositors are to be paid immediately after a failure, and for some time the effect of this provision in the first named state was to keep insolvent banks in operation because there was not enough money in the guaranty fund to pay the depositors if the banks were closed.[1] If the Mississippi fund is deficient at the winding up of the affairs of a failed bank, the depositors will receive pro rata payments until subsequent assessments for the guaranty fund come in.

The deposits of Mississippi state banks June 30, 1914, were $47,359,000. The normal assessment of one-twentieth of one per cent would yield about $24,000, and five assessments, the maximum number in one year, would yield about $120,000. There are no statistics to show whether such assessments are in keeping with previous loss experience in Mississippi. However that may be, the writer is of the opinion that the success of any insurance plan is jeopardized by making the initial fund so small.[2] Fortunately there are as yet few large state banks in Mississippi.

A bill similar to the Mississippi guaranty law was before the Louisiana legislature last winter. It was beaten largely by showing that if any one of the large state banks of New Orleans failed, and if its own assets sufficed to pay 75 per cent of the deposits, the mere interest on the certificates issued for the remaining 25 per cent of deposits would absorb almost all of the assessments for the guaranty fund, leaving no hope of ever paying the principal. After this argument the bill was amended by reducing to 3 per cent the rate on certificates issued in case of failure, but the bill was killed by a vote of nearly two to one.

The guaranty of deposits becomes obligatory on all Mississippi banks on May 15, 1915. There is speculation over the probable attitude of the examiners at that time toward banks of whose condition they are not quite certain. If a

[1] Quarterly Journal of Economics, vol. xxviii, p. 77.

[2] Ibid., vol. xxiv, p. 389, vol. xxviii, p. 99.

bank is closed early in May so that the loss falls on the depositors, when matters might have been smoothed over until the deposits were under guaranty, the examiner who ordered the closing will lose the votes of a certain element of the depositors when he comes up for reëlection. Such a possibility illustrates the unwisdom of electing bank examiners, but it is not likely that examiners will toady to the vote of the depositors of failing banks. The certificate placing deposits under guaranty can be issued only after an examination in which the bank is found to be solvent. A record of failures after such examinations might be as serious a campaign handicap as the displeasure of depositors who thought the examiner ought to have helped them pass on their losses to the guaranty fund. "It seems fairly well understood that not every bank applying for a guaranty certificate has received one." [1]

It is, of course, too early to draw conclusions from the operation of the law. When the writer last inquired, only one state bank had nationalized, and only two national banks had applied for state charters. There is no rush to get into or out of the state system, but up to November 10, 1914, 67 banks, including some of the largest in the state, had voluntarily taken advantage of the guaranty provisions.[2] Some of these believe that the guaranty has brought about a growth of deposits by increasing the confidence of the people. The data are yet too few, however, to warrant any conclusion of the sort. The adoption of a guaranty scheme in Mississippi may tend to substantiate, so far as one example goes, the prediction ventured by the writer a year ago, that from time to time more states would probably supplement their service of bank regulation and supervision by enabling, if not requiring, the banks to effect insurance in a state administered fund for the benefit of depositors.

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[1] Mississippi Banker, vol. i, no. 5, p. 9.

[2] Ibid., vol. i, no. 5, p. 11.